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OP-ED COLUMNIST

Buying Into Failure

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As the Bush administration tries to persuade America to convert Social Security into a giant 401(k), we can learn a lot from other countries that have already gone down that road.

Information about other countries' experience with privatization isn't hard to find. For example, the Century Foundation, at www.tcf.org, provides a wide range of links.

Yet, aside from giving the Cato Institute and other organizations promoting Social Security privatization the space to present upbeat tales from Chile, the U.S. news media have provided their readers and viewers with little information about international experience. In particular, the public hasn't been let in on two open secrets:

Privatization dissipates a large fraction of workers' contributions on fees to investment companies.

It leaves many retirees in poverty.

Decades of conservative marketing have convinced Americans that government programs always create bloated bureaucracies, while the private sector is always lean and efficient. But when it comes to retirement security, the opposite is true. More than 99 percent of Social Security's revenues go toward benefits, and less than 1 percent for overhead. In Chile's system, management fees are around 20 times as high. And that's a typical number for privatized systems.

These fees cut sharply into the returns individuals can expect on their accounts. In Britain, which has had a privatized system since the days of Margaret Thatcher, alarm over the large fees charged by some investment companies eventually led government regulators to impose a "charge cap." Even so, fees continue to take a large bite out of British retirement savings.

A reasonable prediction for the real rate of return on personal accounts in the U.S. is 4 percent or less. If we introduce a system with British-level management fees, net returns to workers will be reduced by more than a quarter. Add in deep cuts in guaranteed benefits and a big increase in risk, and we're looking at a "reform" that hurts everyone except the investment industry.

Advocates insist that a privatized U.S. system can keep expenses much lower. It's true that costs will be low if investments are restricted to low-overhead index funds - that is, if government officials, not individuals, make the investment decisions. But if that's how the system works, the suggestions that workers will have control over their own money - two years ago, Cato renamed its Project on Social Security Privatization by replacing "privatization" with "choice" - are false advertising.

And if there are rules restricting workers to low-expense investments, investment industry lobbyists will try to get those rules overturned.

For the record, I don't think giving financial corporations a huge windfall is the main motive for privatization; it's mostly an ideological thing. But that windfall is a major reason Wall Street wants privatization, and everyone else should be very suspicious.

Then there's the issue of poverty among the elderly.

Privatizers who laud the Chilean system never mention that it has yet to deliver on its promise to reduce government spending. More than 20 years after the system was created, the government is still pouring in money. Why? Because, as a Federal Reserve study puts it, the Chilean government must "provide subsidies for workers failing to accumulate enough capital to provide a minimum pension." In other words, privatization would have condemned many retirees to dire poverty, and the government stepped back in to save them.

The same thing is happening in Britain. Its Pensions Commission warns that those who think Mrs. Thatcher's privatization solved the pension problem are living in a "fool's paradise." A lot of additional government spending will be required to avoid the return of widespread poverty among the elderly - a problem that Britain, like the U.S., thought it had solved.

Britain's experience is directly relevant to the Bush administration's plans. If current hints are an indication, the final plan will probably claim to save money in the future by reducing guaranteed Social Security benefits. These savings will be an illusion: 20 years from now, an American version of Britain's commission will warn that big additional government spending is needed to avert a looming surge in poverty among retirees.

So the Bush administration wants to scrap a retirement system that works, and can be made financially sound for generations to come with modest reforms. Instead, it wants to buy into failure, emulating systems that, when tried elsewhere, have neither saved money nor protected the elderly from poverty.

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